DOW THEORY LETTERS INC.

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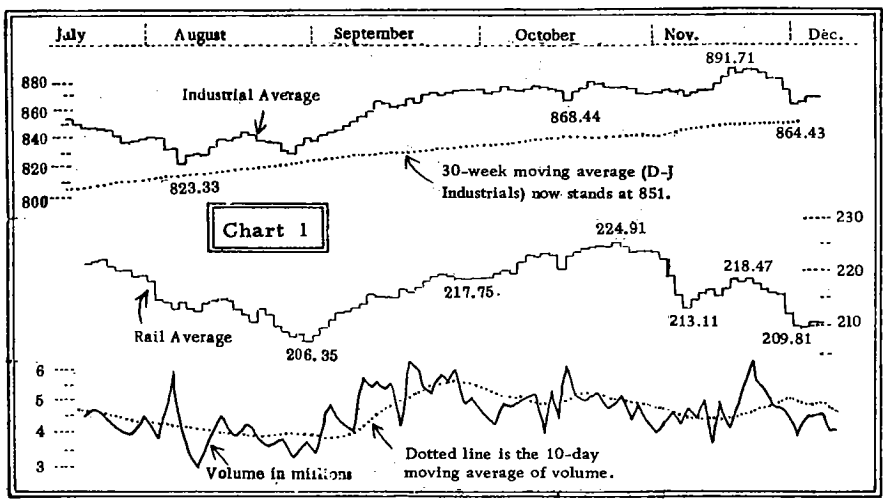
THE MARKET: For a week the air was heavy with sub-rosa arrangements, secret trans-atlantic phone calls, and subtle warnings from high places — all in an effort to constrain the forces which had threatened to tear the international money structure apart. In the end, the "manipulators" forced the skeleton back in the closet — and they have bought time. By last week, the storm appeared to have quieted down.

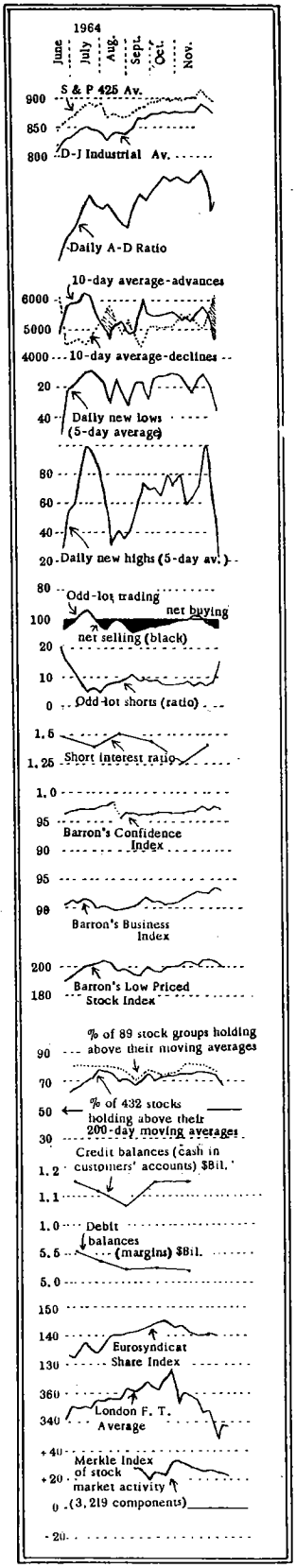
All the while, the Averages have gone about their business of cold appraisal. The reaction to the British monetary crisis on Wall Street was swift. On November 30 the Rail Average sank below its November low (Chart 1), thereby touching its lowest point since last August. A day later (December 1) the Industrial Average plunged 11 points, thus penetrating all previous decline levels back to September.

How much damage has been done? In the opinion of this observer, the direction of the secondary trend is now in doubt — with the burden of proof shifting to the bulls. As stated in Letter 272, Rails have been acting particularly weak, and as seen on Chart 1, the carrier Average has traced a large downward zig-zag. A further comparison of the two Averages is interesting. At last week's low (209.81), the Rail Average had approached within 2% of its August low. On the other hand, Industrials at last week's low (864.47) never got closer than 5% from their August low and had not traced a descending zig-zag. Also of interest is the fact that the Rail Average is currently below its 30-week moving average (not shown) which now stands at 214. Industrials, however, even at the height of last week's selling, stopped a full 13 points above their own moving average. This week saw early Industrial strength, but again Rails showed no inclination to follow.

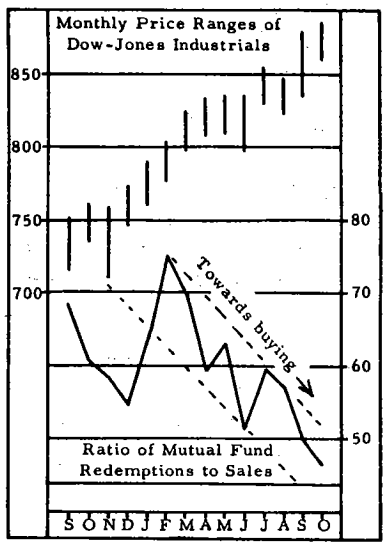
What do we look for next? The writer would now lay great stress on the action of the Rail Average. From the standpoint of Dow's Theory, a Rail advance first above 218.47 (Chart 1), then above the all-time high of 224.91 with Industrials pushing above their own historic high of 891.71 would be needed to reconfirm the bullishness of both the secondary and primary trends. Conversely, a new decline taking Rails below 209.81 and Industrials below 864.43 would indicate that the secondary downtrend is being extended. Should Industrials then plunge below their moving average (now 851) the situation would appear ominous. Finally, I consider the August lows of 823.33 and 206.35 the points which, if broken, would strongly imply a reversal from bull to bear market.

The Composite Chart shows the advance-decline ratio breaking to its lowest level since last August. The 10-day average of advances has dropped to the 4600 level, providing evidence of strong selling pressure (shaded area). Daily new highs have sagged (5-day av.) to 23, lowest level since August while new lows have risen to 37, highest level since June! Odd-lotters have again pushed the 10-day average to the selling side (solid black area) while odd-lot shorts have stepped up their activity. The percentage of 432 stocks holding above their moving averages dropped to 68% last week, and this constitutes the first real deterioration in this index in three months. The percentage count is one of the most sensitive and "fool proof" of all market tools. It is an exact weekly tabulation and must by definition register internal changes in general market weakness or strength. Finally, the London Financial Times Index has rebounded





from its low of two weeks ago, and there is more on this in a later section of the Letter. Conclusion: the indicators reflect a fair amount of weakness, and it will be most interesting to see whether the "traditional year-end rally" will be able to bolster the technical condition of the market. If it does not, the odds are that trouble is waiting in 1965. (Note: with the S & P 425 Industrial Average closing out the month of November at 89.23, the Momentum Index has dropped to a new low of 113. Thus this Index continues to imply trouble ahead. New subscribers may send stamped self-addressed envelopes for copies of Letter 268 which describes the Momentum Index).



The odd-lot statistics present a problem here in that they show the public persistently selling more shares than they are buying — normally a bullish situation. However, (see Letter 266) this writer believes that the public is heavily in the market, but instead of buying individual stocks the public has been buying mutual funds. The reason for the fund preference is undoubtedly the public's disastrous 1962 experience. I have borrowed the accompanying chart from the Drew Odd-Lot Studies (50 Congress Street, Boston, Mass.). The chart shows the ratio of mutual fund purchases to redemptions, and this ratio has just dropped to its lowest level since mid-1962. The public is now buying funds at a rate of better than two shares for every one sold, and this suggests that most people are now anything but bearish about the future of the market (they are merely bearish about their own ability to select the right stock). Fortifying this view is the little clip from the November 30 issue of Barron's. It's hard to adopt a bullish view of either of these phenomena; they simply do not check with the odd-lot figures.

SUNDRY COMMENTS: Following the election I wrote that it was probably to the long-run benefit of this nation that the Democrats had been swept into office again. I added: "For the good of the country I personally feel that all of us should be allowed to see where the the policies of the New Deal-Fair Deal take us and how they are resolved." Evidently, however, our present "money managers" do not want to be around for the story's happy ending. Over the past few months Treasury Secretary Dillon, Treasury Under Secretary Roosa and Chief Economist Heller have all tended their resignations. Anyone would think they did not want to be too near Washington during 1965 (of course I'm only kidding).

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For years we have been told that money was on its way to becoming "worthless." But it is obvious, whether you live in New York, Berlin or Geneva, that money is becoming the topic of conversation. In fact, it is interesting to note what the power of money has been able to do in the last few weeks. Following the British bank rate increase to 7%, the U.S. raised its own rate to 4%. Canada then raised her rate to 4¼%. Next, yields on U. S. Treasury bills jumped to a 4½ year high of 3.86% Time deposits in commercial banks were allowed to rise to 4½% on over-90-day paper, and many commercial banks announced a from-day-of-deposit rate of 4% on savings. Even Malaysia got into the act; she raised her bank rate from 6 to 7 1/4% (which is not funny is you happen to be a Malyasian businessman). Finally, last week four banks boosted their prime rates to 4 3/4%, then faltered as President Johnson requested no "general increase" in interest rates despite the rise in the discount rate. To further "sooth" the nerves of their countrymen, both the President and Reserve Board Chairman Martin also agreed that there would be no "appreciable rise in market yields on long term bonds," and to prove it the "Fed" stepped in last week and purchased a $billion worth of bonds in the open market (thus raising bond prices and lowering yields).

MIP Account Total Reaches Record Rate

The New York Stock Exchange's Monthly Investment Plan moved to its best year in history at the end of October, with a total of 118,694 plans in effect, up from 115,195 in September. At the close of 1963, the figure was 96,809.

To date this year, plan holders have bought 925,921 shares and the 1964 total may exceed the record 989,573 shares purchased in 1960.

* * * * * *

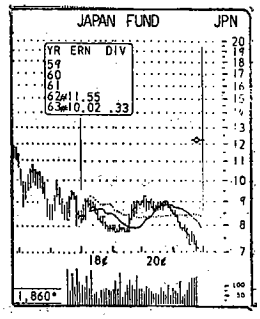
"What about the $4 billion loan to Britain?" I am asked. My answer is that the loan is tantamount to providing a dope addict with a six-month supply of heroin. It may hold off the pain for a while, but as a cure it is not worth a nickel. Britain's real problem is her adverse balance-of-payments. In order to survive, she will have to compete in world markets. A strong nation must either have great natural resources or it must be able to do something better than other nations. In the days when England reigned supreme, she was "master of the seas," and she could out-produce and out-sell all other nations.

Inflation, incompetent government, years of easy living, and a retreat into a world of "pipe dreams" and the "never-never" (the British term for the installment plan) have taken their toll. England's problem is this: she must become competitive again. How do you become competitive? William Hamilton had a phrase to describe it: You "squeeze the water out." It is as simple and unpleasant as that.

* * * * * *

The place where the new money rates are liable to produce the next serious trouble is Japan (see Letter 265). The Japanese boom has been running at white heat, and it has been able to do this by turning over its limited supply of dollar reserves at a tremendous rate. Lately, however, Japan has been running out of its dollar "ammunition." Its stock market has been subject to heavy liquidation, and in desperation the Japan Joint Security Company (made up of leading bankers and brokers)

has been formed for the purpose of supporting the Japanese market (stocks are purchased whenever the Japanese "Dow" drops below 1200). For a "look" at the Japanese market, examine the accompanying chart of the Japan Fund, a N.Y.S.E. issue which is 93% invested in Japanese stocks. This fund "jumped into" the Japanese boom during 1962, but in the ensuing cave-in, the price of the Japan Fund has been cut almost in half.



In an effort to hold its valuable but inadequate supply of dollars, Japan raised its bank rate to 6.57%. With Britain now at 7%, however, Japanese dollar reserves are placed in immediate jeopardy. Following the British bank rate rise, Mr. Yamaguwi of the Bank of Japan voiced the most serious doubts regarding the Japanese financial situation. In the opinion of this writer, the chain of rising interest rates will probably touch Japan next. This could well force the Japanese bank rate to the 8% level.

The following is from a personal note just received from my good friend Irving Weiss (Capital Advisors, 50 Broadway, N.Y.C.). "We are witnessing the strange case of Great Britain, the money borrower — trying to dictate terms (with the help of the U.S.). At the same time the Labor Party is posing as 'Mr. Money Bags' and insisting on international political dominance in its nuclear approach. This is a farce of the type usually seen in the comics or the movies. The Common Market nations have not yet given Britain one cent of the promised $3 billion, and I doubt whether they will until Britain and the U.S. knuckle down to their terms. The terms obviously are: "clean up your own houses by deflating." My guess is that since Labor will not accept these terms, it will be forced to devalue or perhaps raise interest rates even higher. In any event, deflation on a world wide scale is inevitable, and neither Johnson, Dillon, Martin nor the banks can stop it because the entire situation has clearly shifted to Europe — not here."

INTERESTING SPECULATIONS: On November 2 England's Chancellor of the Exchequer Callaghan announced that England would under no circumstances devalue. Since all devaluations have been preceded by stubborn denials, such mouthings only serve to heighten investors' interest in gold. Many people are reluctant to place any large amount of money into gold shares. Nevertheless, they are bothered by the specter of possible devaluation. Actually, a rise in the price of gold would not necessarily change the cost of living at all. In 1933, when the price of gold was raised from $20 to $35 per ounce, the cost of living in the U.S. was subject to almost no change. Nevertheless, if devaluation is eventually forced upon this nation or if the world decides upon multi-lateral devaluation (in order to raise the gold base for all currencies so that further inflation can be set off) holders of gold stocks will stand to gain heavily.

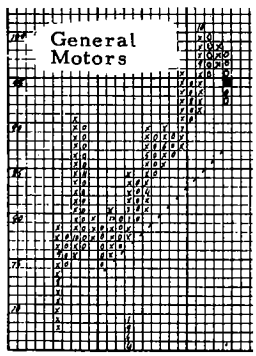
There is an interesting hedge against the possibility of a rise in the price of gold, and it does not require a large cash outlay. A number of low-priced stocks have fair to even large reserves of gold ore, but in many cases their ore is of lower quality. This results in higher costs of gold production. For instance, Free State Geduld (recommended in Letter 270) with rich ore reserves produces gold at $11.54 per ounce. It sells gold at the going rate of $35 per ounce, producing a large profit of $23.46 per ounce $35 minus $11.54).

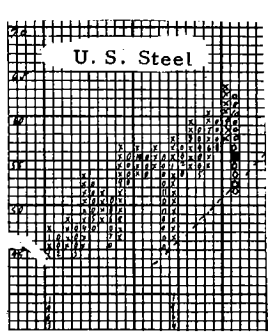
But now let us take President Steyn which produces gold at a cost of $26.34 per ounce. Its profit is only $9.96 per ounce. Let us suppose that the price of gold is raised to $70 per ounce. Most people are unaware of the terrific leverage which would result. Pres. Steyn would then produce a profit of $43.66 per ounce of gold instead of the present $9.96 per ounce. This would mean that Pres. Steyn's profits would rise about 400%, but actually profits increase even more because the company would undoubtedly put into operation many properties which (because of low grade ore) are not profitable at current gold prices. Pres. Steyn now sells for about $3\frac{1}{4}$ and earns about 67¢ per share. On its current dividend of .23 the stock yields about 7.2%. But if gold is raised to $70, Pres. Steyn's earnings would rise at least 400% or to $2.68. If the stock then sold for only five times earnings, it would sell for $13.40. Thus a rise in the price of gold to $70 could easily send a stock like Pres. Steyn from the present $3\frac{1}{4}$ to 13, a huge precentage on a doubling of the price of gold.

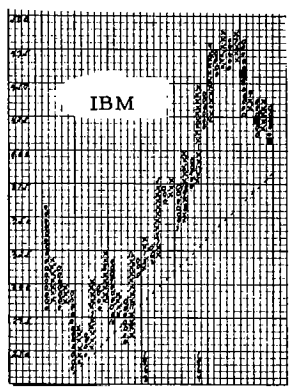
My recommendation for subscribers who want to speculate or hedge against a possible rise in the price of gold: buy equal amounts of President Steyn (S. African) and Dickenson (a Canadian gold mine yielding almost 5% and selling at around 5).

Note: for lack of space, the "Leading Analysts" column will be held over for Letter 274.

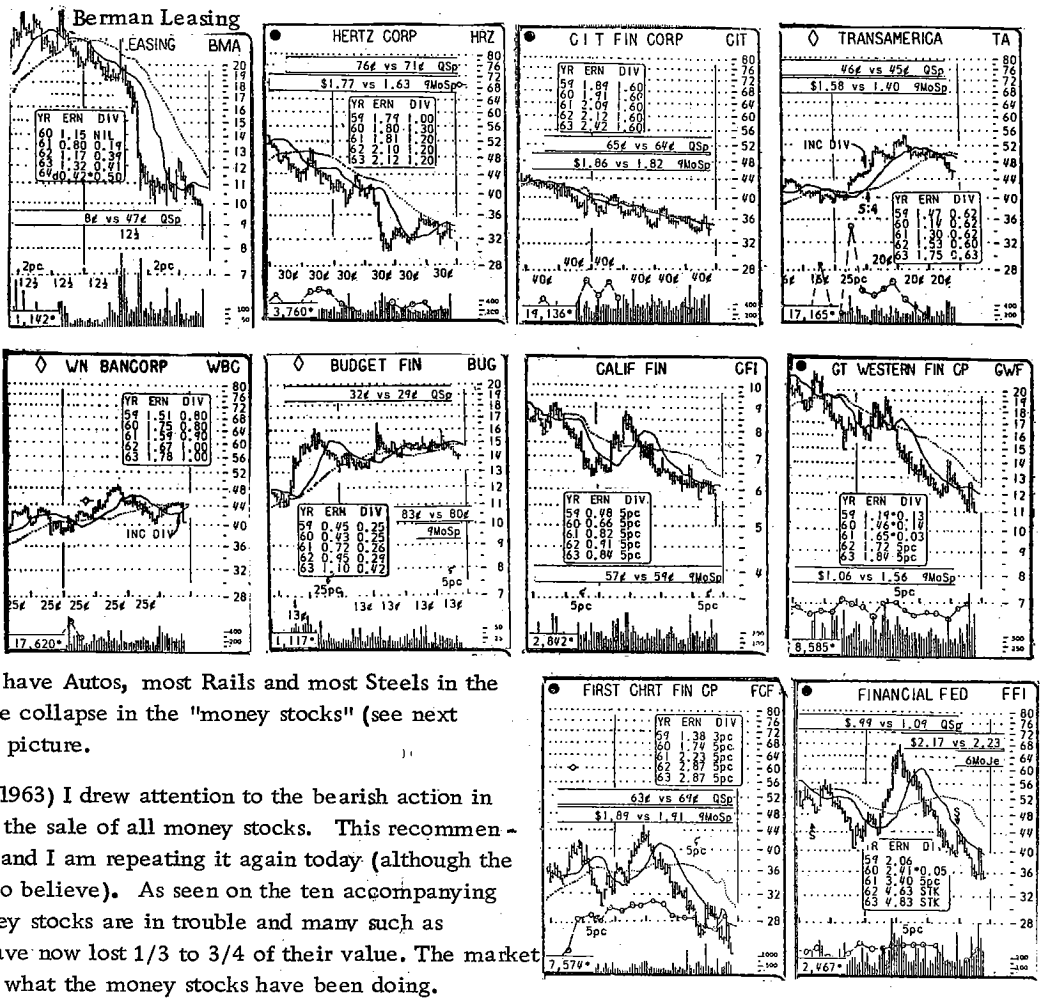
STOCKS: No new recommendations at this time. One of the things that bothers me now (besides the data listed on Page 1) is that four of the real "backbone" stocks of the N.Y.S.E. have now turned bearish. I show these four stocks on point & figure charts because P & F is unequivocal (when a P & F chart shows a







stock as bullish or bearish —that's it. A minimum of "interpretation" is needed). Amer. Tel. turned bearish when it touched 69 (first black square); a second sell signal was given at 66. Gen. Motors turned bearish at 95. IBM turned bearish at 460; a second bearish signal last week at 410. U.S.Steel reversed to bearish at 56; its major uptrend was shattered at 52. Of 17 rail stocks in the Traders Research album, I now count 10 as bearish. When T, GM, IBM, X and many rail issues turn bearish, we can conclude that the market has sustained a good deal of technical damage. Furthermore, Chrysler turned bearish at 63, Ford turned bearish at 55. Thus we have Autos, most Rails and most Steels in the bear column. This together with the collapse in the "money stocks" (see next section) hardly constitutes a hopeful picture.



As far back as Letter 265 (October, 1963) I drew attention to the bearish action in finance stocks, and I recommended the sale of all money stocks. This recommendation was repeated in Letter 256, and I am repeating it again today (although the reasons are now a good deal easier to believe). As seen on the ten accompanying weekly charts, the majority of money stocks are in trouble and many such as savings & loan holding companies have now lost 1/3 to 3/4 of their value. The market discounts ahead, and this is exactly what the money stocks have been doing.

MEXICO: This office is in the rather unique position of being within a twenty minute automobile ride of Mexico (San Diego is situated about 17 miles north of the Mexican border). Last Friday I visited one of the officers of the Banco Nacional de Mexico (Tijuana), and our conversation went something like this: Russell: What rate of interest is your bank paying, Mr. Afanador? Mr. A: Well, we pay only 3% on dollar balances, 4½% on peso balances. Russell: That's not much. But you mean to say I could exchange my dollars for pesos and get more? Mr. A: That is right. Russell: Our own Government pays almost 4% for Treasury bills. Mexico is hardly bidding for dollars at a 3½% bank rate. Mr. A: Ah, but it is. The Mexican Government issues a national bond which is like your savings bond, but it pays at the rate of 7.17%. Furthermore, each bond is numbered, and these numbers are automatically entered in our lottery in Mexico City. If you win at the drawings you can receive seven times the face value of your bonds. Russell: In other words, this is a bond with a "kicker." But how do I buy and sell your bond? Mr. A: You can buy and sell them at most Mexican banks. There is no fluctuation so that they are the same as your savings bonds. Russell: So all I have to worry about is the integrity of the Mexican Government. Mr. A: Well, the Mexican Government will let its citizens (or foreigners) hold gold, which I believe is more than the U. S. will do. Russell: You mean I can buy gold and hold it in your bank? Mr. A: Yes you can. Many Americans buy gold "souvenir" coins here. We also have many people who rent vaults and hold gold bullion here at our banks.

So that is Mexico. All these benefits, wonderful sunny weather, low cost services (a haircut, for instance, costs 50¢ in Tijuana — and it's an excellent haircut), smiling pleasant people, a "low-key" way of life, and bull fights Sunday afternoon at 4 P. M. sharp.

STOCK REVIEWS AND LATE NOTES: Burrough's relative strength (R.S.) line has slipped slightly under its 200-day moving average of R.S. (Traders Research's "performance pattern"). This is not a happy occurrence, but the stock remains bullish. Place stop-loss at 23. As I write this (11 A.M., Tuesday, December 8) Campbell Red Lake is at 19 7/8, an all-time high, and Dome is at 34, a high for the year and 7/8 from its all-time high. These are the two stocks I have recommended most often.

Meanwhile, Rails have broken (intra-day) below 209.81 (see Chart 1). If Industrials now break below 864.43 on increasing volume the utmost care will have to be exercised (see paragraph 4, Page 1).

Point & figure charts courtesy of Chartcraft, Larchmont, New York.
All small weekly bar-line charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas.